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Sensitivity of Share Prices to Dividend Changes : An Empirical Probe into the Information Content of Dividends

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Abstract

The paper peruses the market reaction to dividend changes and the predictive power of company specific factors providing potential explanations for the positive and negative abnormal returns during the pre event and post event period in the event window and on the event day. S&P BSE 500 stocks form the sample which is further categorized into three subsets of decreased, increased, and constant dividends. FY 2014-15 (from April 1, 2014 to March 31, 2015) is the sample period of the study. To investigate the impact of seven independent variables on cumulative abnormal returns of the event period multiple regression is run. Event study methodology with market model is adopted in affirming that decrease and increase in dividend payouts corroborate the information content hypothesis. Age of the company is found to be the key predictor of cumulative abnormal returns, rest are observed to be just minutiae of returns.

JEL Code : D53; G10; G11
Keywords : Dividend; Returns, S&P, BSE, Stock, Share Price, Information, Sensitivity

I. Introduction

DIVIDEND POLICY AND the market value of the firm are considered inextricable and intertwined. Dividend declarations bring conspicuous changes in the wealth of shareholders, which gets evident from the stock price movements in response to these announcements. However, Miller and Modigliani (1961) contended that dividends are used as a device for indicating future cash flows provided market is imperfect. Albeit, a substantial quantum of literature exists brooding over the stock market reactions to dividend announcements yet there is a dearth of empirical evidence to support their information content which leaves the underlying argument untenable. Conjectures about the information embedded in the dividend changes are manifold. The most predominant of all is the managers' foresight, welled up

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The current findings provide the Indian managers with a noteworthy inference in deciding the payouts to steer the positive drift in the common stock prices. Investors do perceive the favorable changes in cash dividends as luminous dimension of the company's financial position. Dividend reductions contrarily posit the despairing financial prospects of the firm.

As the study gives the weakened evidence on the determining power of leverage, life cycle stage, size, growth, free cashflows and profitability in abnormal returns as aftermath of the dividend announcements it provides the further scope to examine and subsume other variables for the future research.

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